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The Economic Geography of Offshore Incorporation in Tax Havens and Offshore Financial Centres: The Case of Chinese MNEs

ABSTRACT

A large share of the outward foreign direct investment of emerging market MNEs is directed towards a small number of specific tax havens and offshore financial centres. The establishment of investment-holding companies for taxation related purposes is frequently adduced as a key motivation (“round-tripping”) for these investments. This explanation, however, accounts for neither the concentration of such investments in specific havens nor the comparatively large national shares of such investments that originate from emerging markets. Here we draw from and build links between the geography of money and finance and international business literatures to conceptually and empirically explore this prominent, if somewhat disregarded, feature of global FDI flows.

Keywords: offshore financial centres, tax havens, theory of FDI, PR China

1. Introduction

The growth of outward foreign direct investment (OFDI) from emerging markets is an important force shaping international economic geography in the wake of the 2008 global financial crisis. This FDI growth has also stimulated interest in the characteristics, motivation, and behaviour of emerging market multinational enterprises (EM MNEs) (Deng, 2012). This in turn has led to calls for new theoretical approaches to explain EM MNEs (Child and Rodrigues, 2005; Matthews, 2006; Luo and Tung, 2007; Hennart, 2012). Useful conceptualisations stress the relative (dis-)advantages EM MNEs experience and how their home country institutional environment influences their development (Luo and Rui, 2009; Luo, Zhao, Wang, and Xi, 2011). Despite this interest, comparatively little theoretical or empirical consideration has been given to the most prominent destination of emerging market OFDI, namely certain specific tax havens and offshore financial centres (THOFCs) and the role they play in the global economy (Palan, 2009; Wójcik, 2013). Here we cross-fertilize ideas found in financial geography with those in internalisation theory, a cornerstone theory of the MNE within the International Business (IB) literature, to develop our explanatory framework. Because classic internationalisation theory lacks a specifically spatial dimension, its integration with economic geography allows us to extend the theory.

Brazil, Russia, India, and China, for example, all record very significant FDI to such destinations. By 2007, one half of Brazil's OFDI stock was located in just three havens (Cuervo-Cazurra and Stahl, 2010) and by 2009, two thirds of Russia's FDI stock was found in four havens (Kuznetsov, 2011). In 2008 and 2009, 40% of Indian OFDI flows went to two havens (RBI, 2010). By 2011, 74% of all mainland Chinese OFDI stock was registered in three tax havens (MOFCOM, NBS, and SAFE, 2012). By comparison the share of FDI stock for developed market economies in tax havens, despite their generally higher rates of

corporation tax, stood at around 25% to 33% (Hines, 2008; Palan, 2009). The high concentration of FDI by EM MNEs in a relatively small number of specific THOFCs requires further explanation. It is often suggested that tax-induced regulatory arbitrage (e.g., Fung, Yau and Zhang, 2010; Shaxson, 2011; Palan, 2009; Lipsey, 2007) is the main driver for such investments. Accordingly, it is argued that ‘most FDI into countries that serve as tax havens generate no actual productive activity’ (Beugelsdijk, Hennart, Slangen and Smeets, 2010, 1). The argument that THOFCs are ‘fictitious spaces’, however, does not explain the geographic concentration of such FDI in specific THOFCs, or why the average national OFDI shares to these jurisdictions are higher for many large emerging economies than for developed economies. In this paper we explore this problem conceptually and empirically for FDI from mainland China, drawing from and building links between the geography of money and finance (Martin, 1999; Wrigley, 1999; Pollard, 2003; Wójcik, 2013) and IB literatures, and more specifically, internalization theory (Buckley and Casson, 1976; McCann, 2011).

The paper is organised into five further sections. Section 2 explains how internalization theory, a mainstay of IB, provides a complementary firm-level perspective to the insights and approaches of financial geography for understanding FDI to THOFCs. Section 3 outlines our data and research methods. Section 4 presents the findings and interprets these through the approaches introduced in Section 2. We conclude by outlining frameworks for explaining FDI to THOFCs derived from the cross-fertilization of internalization theory and financial geography.

2. Financial geography and internalization theory

Considerable shares of the world’s FDI stocks, as well as financial capital, are held in THOFCs. These jurisdictions, at least on paper, are therefore important host and source

countries for MNE activity. The high concentration of FDI to THOFCs (Sharman, 2012), particularly in the case of outward FDI from emerging markets, should make them of special interest to the IB research agenda, given its preoccupation with the MNE. This, however, has not been the case. Rather, economic geographers, and specifically financial geographers, have paid greater attention to financial centres (including THOFCs) (Hudson, 2000), albeit with a comparative lack of such research in the period leading up to the global financial crisis (Wójcik, 2013). We first explore the relevance of financial geography for understanding offshore incorporation in THOFCs before going on to explain how internalization theory provides a complementary approach for thinking about FDI to THOFCs.

2.1. Financial geography, THOFCs and offshore incorporation

Financial geography emerged from a recognition among economic geographers that financial systems and services are ‘lubricants’ that are of fundamental importance to ‘all production circuits’, and therefore ‘central to the operation of the economy’ (Dicken, 2011, 368). It also grew from an acknowledgement that the assumptions of the early researchers within the field of financial geography, which borrowed heavily from neoclassical growth theory, were not realistic (Martin, 1999). With its assumptions of ‘free and costless movement of capital and labour and perfect and ubiquitous information flows between regions, this theory essentially assumes away any regional role for money’ (Martin 1999, 3). In light of the global financial crisis and recognition that capital markets are often imperfect, however, ‘money and finance have now moved from the fringes towards the centre of interest in economic geography’ (Pryke, 2011, 298). This includes a growing recognition of the vital role of THOFCs (Wójcik, 2013; Wainwright, 2011).

In emerging markets financial systems are considered to be quite inefficient and their capital markets, in this neoclassical sense, also imperfect. One might, therefore, expect finance to be highly relevant to the economic geography of emerging markets. The capital markets of the People's Republic of China, for example, are generally considered not to be driven purely by market forces (and are imperfect, in this neoclassical sense) (Karreman and van der Knaap, 2012; Lai, 2011; Vlcek, 2013). And as Martin (1999, 8) points out, 'the institutional geography of the financial system is important because it can influence how money moves between locations and communities'. This is certainly true in China, where State Owned Enterprises (SOEs), especially 'national champion' business groups, have privileged access to capital through the state banking sector at favourable rates and preferential access to capital markets owing to their embedded nature within the Communist Party system (Sutherland, 2009; Karreman and van der Knaap, 2012; Naughton, 2007). Private firms, by comparison, generally face acute challenges in securing bank loans because of state control over lending within Chinese banks and control over domestic stock markets (Shen, Shen, Zu, and Bai, 2009; Lai 2011). Consequently, except for the favoured few, private firms are often crowded out of the domestic capital market (Lu and Yao, 2009). As access to domestic capital is limited by regulation, discrimination by lenders and by the restricted range of outside funders, private firms search for alternative ways to augment their capital stock, sometimes outside of China.

Accessing international capital markets, particularly through international listings, is an increasingly popular alternative for Chinese businesses (Wójcik and Burger, 2010). Capital market imperfections have also been identified in financial geography as an important driver of these EM MNE offshore listings (Clark and Wójcik, 2007; Wójcik and Burger, 2010). To date, however, this literature has been comparatively silent on the firm-level corporate

geography of FDI related to offshore incorporation in THOFCs that often precedes such listings. This is surprising, as the geography of money and finance has taken great interest in financial centres (Martin, 1999; Corbridge, Martin and Thrift, 1994; Leyshon and Thrift, 1997; Hudson, 2000; Roberts, 1995; Mullings, 2004; Cobb, 1998). Pollard (2003), for example, emphasises that the study of specific financial centres is one of four major themes within this sub-discipline of economic geography (see also Martin (1999)). Until recently, however, the main focus within financial geography has been ‘on what might be termed the “geography of financial institutions, systems and markets”’ (Wrigley, 1999) and more generally ‘the “supply” architectures of financial geographies’ (Clark, Pollard and Leyshon, 2009, 735). How firm-level financing has impacted on the spatial economy of firms, by contrast, has been somewhat overlooked (Wrigley, 1999; Lee et al., 2009; Pollard, 2003; Pryke, 2011). In one of the few studies of its kind, for example, Wrigley (1999) explored how firm-level financing decisions had significant impacts on the economic geography of US food retailers. From this study it was concluded that financial geographers had ‘traditionally underemphasised types of restructuring which involve transformations of the capital structure and ownership configuration of firms’, despite their important spatial consequences (Wrigley, 1999, 186). Investments to THOFCs, as we will later show, often involve these kinds of transformations.

This focus on the broader financial architecture and institutions, as opposed to firm-level financing and its impact on economic geography, also strongly manifests itself in the specific analysis of THOFCs by economic geographers (Cobb, 1998; Hudson, 2000; Roberts, 1994, 1995). Economic geographers, for example, have analysed the role of THOFCs in fostering regulatory competition between states (Hudson, 2000; Mullings, 2004); the way in which THOFCs develop their own competitive advantages (Cobb, 1998); and how THOFCs shape

the global financial system (Roberts, 1994). The importance of THOFCs to the geography of the global financial system and architecture, including the growing volumes of offshore financial flows through THOFCs and their recent involvement in the global financial crisis, has been noted (French, Leyshon and Thrift, 2009).

Interestingly, economists, in a somewhat similar fashion to economic geographers, have similarly taken a broadly macroeconomic approach to exploring THOFCs. This, for example, has involved undertaking modelling using national level data (Rose and Spiegel, 2007; Dharmapala and Hines, 2009). To date, therefore, the ways in which firm-level financing via THOFCs impacts on corporate economic geography has received comparatively less attention, both within economics and economic geography, with only a few exceptions (Wójcik, 2013; Wainwright, 2011). Yet, as noted, very large shares of global FDI flows are channelled through THOFCs. They therefore constitute an important component in the geographical map of global FDI stocks and flows and MNE activity, a subject of perennial interest to economic geographers (Dicken, 2003, 2011; Coe and Yeung, 2001; McCann, 2011).

In certain ways, the approach of IB scholars has mirrored the trends found in financial geography. In particular, the extent and ways in which firm-level financing decisions specifically influence the location decisions of MNEs have been somewhat overlooked. This omission is surprising, given it is well known that large volumes of FDI pass through THOFCs and that significant MNE activity is undertaken offshore, including the raising of capital and property rights transactions. This type of FDI, however, is often not considered to be involved in physically ‘productive activity’ (Beugelsdijk et al., 2010). It also does not easily fit under the categories of market, efficiency or asset seeking investment motivations,

or horizontal and vertical investments (Shatz and Venables, 2003), that the IB literature often focuses upon. As a result, it is often dismissed. One result has been the tendency to consider FDI to THOFCs as mainly driven by tax induced regulatory arbitrage (Fung et al, 2010) and not to treat it as genuine MNE activity. It has been noted, for example, that empirical studies looking at the location choice of MNEs simply often exclude such FDI (Beugelsdijk et al., 2010). It is perhaps unsurprising then that Witt and Lewin (2007) have recently pointed out that all FDI seen purely as an ‘escape response’ to non-supportive home country institutional environments, including capital markets, remains a much neglected area in the IB research agenda.

To summarise, there are some interesting and close similarities between the ways in which economic geographers, and specifically those with an interest in money and finance, and IB scholars, have elided from their analysis the impact of firm-level financing decisions on economic geography and investment location decisions. Partly as a result of this, conceptual and empirical firm-level analysis of why MNEs use specific THOFCs, what they do in them, and the implications of their use, is still rather limited. Internalization theory, with its specific focus at the micro-level, as well as its concern with imperfect markets, provides a complementary approach to those found in economic geography for further exploring offshore incorporation and FDI to THOFCs.

2.2. Internalization theory and the economic geography of FDI to THOFCs

Despite the interest of economic geographers in both financial centres and the role of capital market imperfections in determining economic geography, there remains a dearth of firm-level analysis explaining offshore incorporation in THOFCs. Following from this, there are a number of reasons why the location choice of FDI as explained by internalization theory

(Buckley and Casson, 1976; McCann, 2011), provides a complementary approach to the financial geography literature looking at THOFCs. Firstly, internalization theory, which is based upon transaction cost economics and the theory of the firm, provides an explicit micro-level perspective with which to analyse offshore incorporation and the related FDI to THOFCs. As noted, financial geography has paid less attention to how firm-level financing decisions impact upon firm-level corporate economic geographies. Rather, its interest has been directed more towards the geography of financial supply architectures and systems (Wrigley, 1999). Secondly, financial geography grew, in part, from the recognition that imperfect capital markets shape economic geographies. Internalization theory specifically deals with the role imperfect markets, including the impact of imperfect capital markets on FDI (Buckley and Casson, 2009), lending itself to cross-fertilization with financial geography.

Thirdly, emerging markets, as noted, are renowned not only for their domestic capital market imperfections but also for their relatively poor domestic institutional environments and the high transactions costs that these can create (Khanna and Yafeh, 2007). Emerging market businesses are often forced to undertake a wide variety of innovative responses in an attempt to mitigate these high transactions costs. A considerable literature, for example, explains the formation of ‘business groups’ as preferred organisational forms in emerging markets as one such response mechanism (Khanna and Yafeh (2007) summarise this extensive literature). The most successful THOFCs, by contrast, are recognized for their well-developed legal and financial systems, particularly those havens that also act as offshore financial centres (OFCs) (Dharmapala and Hines, 2009; Rose and Spiegel, 2007; Roberts, 1995). The drive for offshore incorporation and FDI flows may, therefore, be driven not only by domestic capital market imperfections and the needs of EM MNEs to augment their existing capital structure,

but also by access to a more favourable institutional environment. Internalization theory accounts for the impact of imperfect markets and also draws attention to these broader institutional misalignments, including how businesses exploit multi-country presence (Dicken, 2003). These may drive what has been referred to as ‘institutional arbitrage’ (Boisot and Meyer, 2008; Kedia and Mukherjee, 2009), in which EM MNEs use THOFCs to internalise institutional and market differences between countries, with the strategic intent of guaranteeing their long term economic viability. As such, firm-level financing and institutional arbitrage decisions may become an important determinant of where MNEs invest.

Finally, we note that economic geographers have seen MNEs as geographical constellations of social relationships (Dicken, 2003; Yeung, 2009) that invest along horizontal and vertical axes (Shatz and Venables, 2003). In addition, they have at times decried what they see as the ‘methodological nationalism’ of some IB scholars, in so far as they too closely follow the precepts of neoclassical economics (as exemplified by Yeung (2009, 204). Neoclassical economic theories and IB variants that build on them, for example, assume free and costless movement of capital and labour and perfect and ubiquitous information flows. It is argued these theories, including internalization theory, do not therefore explicitly address the role of territory in the case of financial flows and systems, or the spatially embedded nature of MNEs (Martin 1999; Yeung, 2009; Seo 2011). We look to address these criticisms here by arguing that localities and their specificities do matter, are location bound and are very difficult to transfer. As such, we regard the MNE as a locally embedded network of relationships, focussing here on financial relationships in particular. By doing so the paper progresses our understanding of the globalisation of EM MNEs and their corporate financial geographies (Coe and Yeung, 2001). It also advances the theory of the MNE by focussing on

the wider institutional framework of the global economy and relaxing the assumption that MNE's 'decision making and corporate behaviour are the same everywhere' (Yeung 2009, 203). Geography is therefore conceptualised as a central component of the existence of MNEs (Beugelsdijk, McCann and Mudambi, 2010).

3. Research method, sample and analysis

We look at the specific case of the People's Republic of China to explore the use of THOFCs by EM MNEs in further detail, focusing in particular on the use of two of the more important THOFCs used by Chinese MNEs, the Cayman Islands and BVI, as well as their interaction with Hong Kong. China is a particularly interesting case because of the domestic institutional configuration and its evolution over time. Since 2000, mainland China's outward OFDI has grown at a faster rate than at any time in its history. This is the result of domestic policy liberalisation and state promotion (Buckley, Clegg, Cross, Liu, Voss, and Zheng, 2007; Luo, Xue, and Han, 2010). The majority of Chinese OFDI, however, is destined for several specific THOFCs (see Table 1). These constituencies accounted for 69-87% of the annual outflow between 2003 and 2011 so that, as noted, the stock of Chinese investments in these locations now stands at around 80% of the total. In 2006, one tax haven alone, the Cayman Islands, had become the largest recipient of Chinese OFDI, with 44% of officially recognised flows (and 18% of its global OFDI stock). Subsequently, the THOFC Hong Kong became the lead recipient ahead of the Cayman Islands and British Virgin Islands (BVI) (MOFCOM, NBS, and SAFE, 2012). In addition, by 2006, 18% of China's utilised inward FDI originated from the BVI. Indirect financial flows to the Cayman Islands and BVI, moreover, are often channelled via Hong Kong (another OFC and haven) and arguably remain very large. As such, the triad of the Cayman Islands, BVI and Hong Kong remain very important to understanding the characteristics, motivations, and behaviour of Chinese MNEs (Vlcek,

2013). Or, as Kolstad and Wiig (2012, 33) note, the ‘question of how to account for investment flows through tax havens is important for a more complete understanding of Chinese FDI’.

***** TABLE 1 ABOUT HERE *****

3.1. Sample selection

As noted, economists have employed aggregated OFDI data to explore the impacts of THOFCs on regional capital markets (Rose and Spiegel, 2007). Economic geographers have also used specific haven examples to explain ‘bottom up’ accounts of tax haven development (Roberts, 1994; Corkill-Cobb, 1998; Hudson, 2000). Comparatively little research, owing to the inherent secrecy of havens, has been undertaken at the micro (firm)-level. This veil of secrecy makes it difficult to determine which firms have interests in THOFCs and what activities they engage in once offshore. One of the few windows through which to observe such behaviour is the publicly available data of firms that have raised capital on foreign stock markets. All businesses listed on stock markets in the United States, for example, must submit various formal documents to the United States Securities Exchange Commission (SEC), including annual financial statements and reports. It is a requirement of the SEC that foreign private issuers complete a 20-F form annually (SEC, 2010). These submissions, owing to legal obligations, are generally candid in nature and provide detailed information on company accounts; capital raising activities and use of proceeds from such activities; information on the organizational structure; subsidiary information including the country in which any listing vehicle is incorporated and the use of offshore vehicles for such purposes. As such, the usage of 20-F forms is now well established in corporate governance and accounting research (e.g., La Porta, Lopez-De-Silanes, Shleifer and Vishny, 2002).

Our sample of firms is taken from all firms listed on the United States SEC EDGAR database classified as having their country location (i.e., primary business activities) in China (totalling 869 firms as of June 2010). The vast majority of Chinese firms listed in the United States are incorporated offshore. From these we then identify and select firms meeting the following criteria: all firms submitting 20-F forms in the period January 2009 through to June 2010, to ensure the sample included only operational firms; all firms incorporated in OECD recognised tax havens (excluding blank check companies, i.e., a development stage company that has no operating activities or specific business plan); and all firms originating in China as wholly Chinese owned entities. This left a final sample of 72 firms (Table 2)¹.

The data for each firm within our sample covers the time period from each firm's first 20-F submission until its latest submission, either in 2009 or 2010. Qiao Xing Universal Telephone was the first firm within our sample to submit a 20-F form to the SEC in 1999. Accordingly we analyse each of its twelve 20-F form submissions and its two 20-F form amendment submissions which cover the time period 1999-2010. There are 13 firms within our sample which listed in the 2009-2010 period and have submitted only one 20-F form to date, e.g. 7 Days Group Holdings. Our analysis is therefore informed by its single submission. Section 4 ('company history') of each 20-F form, however, includes information on the origins of the firm within China and details of its incorporation process within the tax havens. The information provided covers the time period from the incorporation of the firm offshore until the present.

***** TABLE 2 ABOUT HERE *****

¹ A detailed overview of our sample is available from the authors.

All of the firms we analyse, by definition, have raised foreign capital in the USA. This may limit the conclusions that we can draw, as we cannot compare our findings to firms that have used offshore vehicles to trade on non-American markets, or have invested in the havens to raise capital through venture capitalists or other means. This said, given the legal obligations to accurately report information in SEC submissions, the use of 20-F forms partially overcomes issues of reliability and credibility from which primary data often suffer.

3.2. Data analysis

Following from our approaches outlined in section 2, we are concerned in the internalization of arbitrage opportunities related to capital market imperfections and other institutional constraints and whether these activities take place within particular THOFC jurisdictions as well as the reasons why Chinese MNEs might use specific THOFCs. We are therefore interested in which offshore jurisdictions Chinese firms use to (1) access capital and (2) to avail of a favourable institutional environment, including the legal institutional and regulatory environment conducive to doing business, as well as how they exploit this environment using multinational advanced business service (ABS) providers, including financial (i.e. investment banks) and professional service MNEs (i.e. legal and accounting firms). Our intention is therefore to explore some of the reasons, moving beyond taxation related reasons alone, for the use of THOFCs.

We note the jurisdiction of the listing vehicles and the amount that is raised in each company's initial public offerings (IPOs), also taking into account follow-on offerings and changes in bank borrowing following the IPOs, as proxies for capital raising activity in specific jurisdictions due to capital market imperfections in China. The jurisdiction of

incorporation and magnitude of the capital raised in the IPO (to give a sense of the importance of this activity) is calculated from information within the 20-F's section 4 ('company history'); section 5 ('investing activities' and 'financing activities'); and section 14 ('material modifications to the rights of security holders and use of proceeds'). To gain insights into the influence of high transaction cost activities and the specific THOFCs used for reducing these (Naughton, 2007) we explore whether the firm has used the offshore market for property rights to acquire other China based businesses that are held through offshore special purpose vehicles. Specifically, for each firm we check whether it has acquired controlling interests in any other Chinese company (either privately held or publicly listed) that itself is controlled through an offshore vehicle as well as the preferred THOFC of jurisdiction for this activity. We take this as a useful proxy for the use of offshore institutions and the favoured jurisdictions, as it explicitly reflects how Chinese businesses restructure their operations back in China through offshore vehicles. It therefore provides one further indicator of how offshore institutions are used for their benefit. Sections 3, 4 and 7 of the 20-F form, covering 'key information'; 'company history'; and 'related party transactions', respectively, were used to identify such activities. For each firm we used all available 20-F submissions.

Our final area of investigation relates to the nature of China's OFDI to THOFCs *vis-a-vis* the domestic institutional environment as it changes over time. The new Enterprise Income Tax Law, introduced in mainland China in January 2008, has important implications for the use of offshore holding companies. It has harmonised corporate tax rates for foreign (i.e. including Chinese business owned via offshore holding-companies, as in our sample firms) and domestic businesses, as well as introducing new punitive withholding taxes for offshore companies. These tax changes potentially reduce the tax benefits of incorporating offshore.

The new law, however, also provides that some foreign investors (i.e. including offshore holding-companies that own domestic mainland subsidiaries) may benefit from specific inter-governmental agreements on taxation (Buckley et al., 2008). Firms that are incorporated in a country or region with which China has a tax treaty may benefit from reduced rates of withholding taxes levied on dividends paid to offshore holding companies. Hong Kong has negotiated a highly favourable treaty (discussed later in section 4.3). The deployment of a Hong Kong based holding company directly holding mainland China subsidiaries, therefore, is used here as a proxy for responsiveness to institutional change. Sections 3 and 4 of the 20-F form covering ‘risk factors’ and ‘organisational structure’, respectively, were used to establish how institutional changes influence investment decisions and the type of holding company structures used to mitigate these effects.

We use three examples to illustrate our findings, supported by aggregate data from the sample. The selections were made on the basis that each case was representative of our sample firms (Yin, 2008). The examples provide richer detail (e.g. Eisenhardt, 1989) of the activities undertaken by Chinese firms within THOFCs, and particularly for the three most commonly used havens of the Cayman Islands, BVI and Hong Kong.

A limitation of our method is that it uses a sample of publicly listed businesses from one emerging market (mainland China) listed on US markets to gain insights into offshore incorporation. Further research could look at publicly listed Chinese companies on non-domestic stock markets, such as Hong Kong and Singapore, with primary business activities in China. It could also explore whether our arguments hold for other EM MNEs. Our preliminary investigations, however, suggest that Chinese MNEs are not singular in

exploiting the access to capital markets and superior institutional environments of specific THOFCs.

4. Findings and Discussion

Financial geographers have identified the important role of imperfect capital markets and firm-level financing decisions in driving the spatial decision making of firms (Martin, 1999; Pollard, 2003; Wrigley, 1999). As with the IB literature, however, there is still limited firm-level research on FDI to THOFCs, albeit that such jurisdictions are gaining increasing recognition in economic geography (Wójcik, 2013; Wainwright, 2011). Addressing this gap, our findings show that one way in which Chinese businesses address domestic market imperfections that have been created and sustained by government policies and regulations, such as the markets for capital and property rights, is by establishing offshore companies. As a result, they are able to reduce the costs of raising capital, restructuring their domestic businesses, and can pursue short-term and long-term strategic goals via the use of offshore vehicles. The transaction cost approach of internalization theory argues that FDI is determined by the internalization of imperfect markets across different locations, enabling MNEs to control crucial intermediate markets in goods, factors and services (Buckley and Casson, 1976). It also provides a useful explanatory framework for understanding why such high levels of FDI are found in certain specific THOFCs, which we now discuss.

4.1 Capital market imperfections: the use of THOFCs for international listings

According to internalization theory, outward investors seek locations that minimise the cost of their activities so as to achieve optimality in location for the firm. Buckley et al. (2007) applied this theory to Chinese OFDI and found that special determinants arising from imperfections in China's capital market were a major factor in Chinese FDI. The capital

market in China, in the aforementioned neoclassical sense, is imperfect (Huang, 2003; Karreman and van der Knaap, 2012) and this in turn influences OFDI. A limited number of studies have also noted the importance of raising capital on foreign capital markets (Wójcik and Burger, 2010; Xiao, 2004). Xiao, for example, has noted that OFDI to tax havens and OFCs ‘creates value added much like the financial sector’s role for the real economy’ (Xiao, 2004, 12). Xiao’s argument is not well developed, though the implication is clear: registering as a company in a tax haven could enable Chinese companies to circumvent imperfections in the domestic Chinese capital market. This may create greater value than they could obtain by listing on domestic stock exchanges, if such an option were even available.² In the Chinese case, as access to domestic capital is limited by regulation, discrimination by lenders and by the restricted range of outside funders, private firms in particular must search for alternative ways to augment their capital stock, sometimes seeking capital outside of China. Financial geographers have also emphasised that the institutional geography of the financial system influences the movement of money between locations and different communities or groups (Martin, 1999). Investment in THOFCs via the creation of offshore holding companies is one such way of augmenting existing capital, particularly for private businesses. Of our sample of 72 firms, in total 66 were incorporated in the Cayman Islands (55), BVI (7) and Hong Kong (4), with the remaining six in other havens. It is of interest to note, therefore, that by far the most commonly used offshore listing vehicles also correspond to some of the main destinations of officially recorded Chinese OFDI (Table 1). For these firms, details of the largest five shareholders are provided in their 20-F forms. The majority are usually owned and controlled by their founders (either directly, or beneficially through further BVI companies). Many are prominent Chinese entrepreneurs. In our 72 sample firms we identify 42 in which the combined holdings of the three largest individual shareholders exceed 20% of

² The Chinese government prevents companies (even some large SOEs) from listing on Chinese stock markets – thereby forcing them to go overseas for financing (Kung and Cheng, 2012).

their companies' ordinary shares, a threshold commonly considered sufficient to lock in control (La Porta et al., 2002). These individuals are identified as 'founders' in the 20-F submissions and are Chinese nationals. Nearly all of the other sample firms, moreover, have significant stakes owned by Chinese nationals, though sometimes these ownership shares have been diluted by other investors. Chinese OFDI to THOFCs can therefore be seen as a strong response to Chinese domestic capital market imperfections, particularly by private entrepreneurs.

Collectively, the 72 sample firms raised estimated gross IPO proceeds of US\$11bn and net proceeds of US\$9.8bn.³ Major international investment banks, which all have significant operations in Hong Kong, acted as underwriters and co-ordinated the global offerings of our sample companies. This included CLSA, UBS, Credit Suisse First Boston, Morgan Stanley, JP Morgan, and ABN AMRO Rothschild. It is striking that 55 sample firms were incorporated in one haven, the Cayman Islands.⁴ Of these, moreover, 40 had one or more BVI holding companies owned by the Cayman Island listing vehicle, which usually in turn held the mainland subsidiaries. The sample firms commonly followed similar procedures of incorporation prior to listing, with 23 of the sample firms first registering in the BVI prior to incorporating their listing vehicle in the Cayman Islands.

Suntech Power provides us with a representative example of the listing process, illustrating the sequence whereby Chinese businesses develop their offshore corporate structures.

Suntech was originally incorporated in Wuxi (Jiangsu province), China as Suntech China. It

³ This estimation is based on the average difference between gross and net IPO proceeds directed towards underwriting fees, advisory fees and related costs from firms returning both figures, applied to omitted IPO values from firms only returning either gross or net IPO proceeds in their 20-F statements.

⁴ Hong Kong symbolises well how advanced business services located here link the city with other important cities (in PRC: Shanghai), other offshore jurisdiction (CI, BVI) and the final country of business activity (China or elsewhere) (cf. Wójcik, 2013).

designs, develops and manufactures a variety of photovoltaic cells and modules and is one of the world's largest producers. The following quote, taken from Section 4 of its 20-F form submitted in 2006 illustrates the process whereby offshore vehicles are used to raise capital and uses language that is echoed by a majority of sample firms in their 20-F forms:

Suntech China was incorporated in January 2001 and commenced business operations in May 2002. *To enable us to raise equity capital from investors outside of China, we established a holding company structure* by incorporating Power Solar System Co., Ltd., or Suntech BVI, in the British Virgin Islands on January 11, 2005. Suntech BVI acquired all of the equity interests in Suntech China through a series of transactions that have been accounted for as a recapitalization. In anticipation of our initial public offering, we incorporated Suntech Power Holdings Co., Ltd., or Suntech, in the Cayman Islands as a listing vehicle on August 8, 2005. Suntech became our ultimate holding company when it issued shares to the existing shareholders of Suntech BVI on August 29, 2005 in exchange for all of the shares that these shareholders held in Suntech BVI. We conduct a significant portion of our operations through Suntech China. (Suntech, 2006, 27)(emphasis added)

***** FIGURE 1 ABOUT HERE *****

Suntech illustrates the typical processes and structures predominantly used by Chinese businesses when raising capital on foreign stock markets. Suntech raised net IPO proceeds of US\$321.8mn on the New York Stock Exchange (NYSE) in 2005 (Suntech, 2010). CLSA Asia-Pacific Markets, based in Hong Kong, was an important underwriter of the IPO (which also included Credit Suisse First Boston and Morgan Stanley). Once in place, these offshore structures allow Chinese companies to raise further capital. In 2009, for example, Suntech closed a follow-on offering on the NYSE with net proceeds of US\$277mn (Suntech, 2010).

Suntech has made use of two corporate bond offerings to raise capital in 2007 and 2008, with net proceeds of US\$485.6mn and US\$560.1mn, respectively. Following its IPO in 2005 Suntech's access to short term bank borrowing dramatically improved, its net proceeds from short term bank borrowing increased from US\$15.3mn in 2005 to US\$183.6mn in 2006 and to US\$305.8mn by 2008 (Suntech, 2007, 2010). Suntech was able to realise net proceeds of US\$294.1mn in longer term bank loans by 2009 (Suntech, 2010). Both Chinese and international banks lent to Suntech.

The capital raised has allowed Suntech to expand its production capacity, exploit its China based low-cost manufacturing model and to allow it to undertake a series of acquisitions in industrialised countries. For example, in 2006 Suntech acquired MSK in Japan (now Suntech Japan; see Figure 1) – a leader in the integrated photo-voltaic market (Suntech 2006). In 2008, Suntech acquired one of its component suppliers, KSL-Kuttler, a leading German based manufacturer of automation systems for the printed circuit board industry. In 2009 Suntech acquired a 76.6% interest in CSG Solar, a German company involved in developing, producing and marketing PV cells (Figure 1).

The strong preference to incorporate a listing vehicle in the Cayman Islands warrants further analysis. While zero rates of tax on income and capital gains and secrecy regulations are undoubtedly an attraction of the Cayman Islands, which can be exploited in numerous ways, such as via the use of complex transfer pricing and intra-corporate loan strategies, it is important to stress numerous other THOFCs would also meet these criteria (OECD, 2010). We believe the most important reason for Chinese firms to specifically favour the Cayman Islands as a base for their listing vehicles is that it allows them to minimise their costs of raising capital. The Cayman Islands is the world's fifth largest financial centre by asset size

and an important adjunct to the North American capital markets (IMF, 2009; Roberts, 1995). The most recent comparisons show it had 464 offshore banks, compared with nine in the BVI, 30 in Cyprus and 77 in Guernsey (Hampton, 2002). As an OFC it also specialises in business related cross-border financial services, particularly in banking. It held total banking assets of US \$1.7tr in 2009 (IMF, 2009). It has become jurisdiction to the largest number of investment funds in the world, with over 9,000 funds and net assets approaching US\$2.3tr in 2007 (IMF, 2009). The Cayman Islands also hosts 75% of the world's hedge funds and nearly half of the estimated US\$1.tr assets under management (HOC, n.d.). It therefore provides ready access to deep pools of international capital (IMF, 2009). Most importantly of all, however, by vertically locating a listing vehicle within the Cayman Islands, IPOs may also be undertaken on multiple stock exchanges, including both Hong Kong and US stock exchanges. Historically, no other havens have provided this facility (Greguras et al., 2008). Thus, the Cayman Islands is the jurisdiction of choice for listing vehicles and raising capital. As such, finance, accounting and legal professionals argue that 'in many, if not most cases, the use of a Cayman vehicle is not wholly or mainly for tax planning purposes' (Knowles, 2010, 1). This is not, of course, to say zero tax rates are unimportant, but simply that many other jurisdictions also offer such incentives.

Financial geographers have drawn attention to the role of imperfect capital markets in shaping economic geography (Martin, 1999) even if to date research showing how corporate financing affects firm location decisions has been limited (Pollard, 2003; Wrigley, 1999; Pryke, 2011). As noted above, economic geographers have 'traditionally underemphasised types of restructuring which involve transformations of the capital structure and ownership configuration of firms' (Wrigley, 1999, 186). Similarly, IB research has largely overlooked the importance of imperfect capital markets and firm-level financing on location choice (Witt

and Lewin, 2007). The high concentration of EM MNE FDI in the Cayman Islands is a novel but important example of how firm-level financing decisions and responses to imperfect capital markets in the home country alter EM MNE corporate economic geography. The spatial consequences of the decisions that we have focused on here are related to incorporation in offshore jurisdictions. As Roberts (1994) puts it, in some senses these are ‘fictitious spaces’, as the businesses in question usually do not physically relocate there and no physical production is undertaken offshore. Nonetheless, the use of these jurisdictions does have very significant impacts on the more tangible, value-adding productive activities of these MNEs, somewhat akin to vertical FDI. In this light, Pollard’s (2003, 446) comment that ‘finance is a fundamental part of economic co-ordination that is not logically prior to or separate from production’, is highly germane (see also Sarre (2007) for an elaboration on the links between finance and production). It has been shown, for example, how the capital raised offshore facilitates both further domestic and international expansion of Chinese businesses (Sutherland and Ning, 2011), illustrating its direct links to production.

4.2. Institutional misalignments: the offshore market for Chinese companies

THOFCs may also provide institutional support for the restructuring of domestic operations back in China. Boisot and Meyer (2008) conceive of Chinese OFDI as a means of ‘institutional arbitrage’, that is the strategic pursuit of an MNE to exploit differences in the configuration of the professional, administrative, cultural, economic, or geographic environment between countries to their own advantage (Dicken, 2003; Ghemawat, 2003; Gaur and Lu, 2007; Zhao, 2006). The market for property rights of other Chinese businesses, for example, was late in its development and the domestic transactions costs are reportedly high (Jefferson and Rawski, 2002; Naughton, 2007). OFDI to THOFCs simultaneously allows Chinese firms to reduce costs arising from various types of institutional

misalignments. Chinese firms, moreover, avail of administrative and professional institutions, and engage in a form of arbitrage whereby they exploit the other comparatively superior institutions of foreign markets. As noted, these superior offshore institutional environments are also exploited via the use of large multinational ABS providers which themselves typically have a significant offshore presence. For example, we found 23 of the 72 20-F submissions in our sample were directly audited via the Hong Kong registered affiliates of several large MNE accounting firms (with KPMG in the lead, followed by Deloitte Touche Tohmatsu and Price Waterhouse Coopers). A further 25 were audited by the local mainland subsidiaries of these MNEs (typically in Shanghai or Beijing). Our sample firms show that the use of established MNE business service providers, which typically have both a strong offshore and onshore presence, are used by our sample firms so as to fully exploit the benefits of offshore incorporation.

It is notable that important transactions involving the buying and selling of Chinese businesses take place via these offshore jurisdictions. In our sample firms we find evidence that 22 firms have acquired fully or partially one or more other China based companies that are themselves held through offshore holding companies, supporting the idea that havens offer a supportive institutional environment for organisational restructuring. Chinese firms may also benefit from foreign banking and financial expertise, which can add value to the Chinese capital (Zhan, 1995), as well as more sophisticated and stable legal institutions (Huang, 2003). This allows businesses to undertake significant restructuring of their mainland operations via THOFCs and reduce their exposure to, and negotiation with, Chinese institutions in this process. As with the high transactions costs incurred in domestic capital markets, transactions costs in the domestic market for property rights may force businesses to seek less costly and effective alternatives. More specifically, when transactions costs are

high, as they are in China (Buckley et al., 2007), Chinese firms investing in the havens may follow diminution or escape strategies to reduce exposure to domestic institutional conditions (Witt and Lewin, 2007). The BVI, in contrast to the Cayman Islands, specializes in international business company (IBC) registrations and far outstrips all other havens in this regard (HOC, n.d.). In 2002, for example, it had around 400,000 IBCs compared, for example, to only 60,000 in the Cayman Islands or 24,000 in Cyprus and 30,000 in Netherlands Antilles (Hampton, 2002). Qualitative research on Chinese investors using the BVI shows they have particular regard for the BVI's legal system (Maurer and Martin, 2011). This may explain why the overwhelming majority of property rights transactions in our sample firms are undertaken in the BVI.

Xinhua Sports & Entertainment Limited (XSEL) provides an interesting example of how Chinese businesses use THOFCs for property rights transactions. It is a sports and media entertainment group that conducts all of its operations in mainland China. It has grown significantly since its inception, primarily through the acquisition of assets and businesses and development of its distribution channels (Xinhua, 2008). XSEL undertook a different sequence to most of the sample firms, by directly incorporating in the Cayman Islands. It completed its IPO on the NASDAQ in 2007, receiving net proceeds of US\$200.3mn (Xinhua, 2008). XSEL has also raised capital via placements of convertible preferred shares (US\$60mn in 2006 and US\$29.2mn in 2008) and convertible bonds in 2008 (US\$30.7mn) (Xinhua, 2009). Its access to bank borrowing has dramatically increased since its IPO, from US\$5.6mn in 2006 to US\$48.7mn in 2007 and to US\$40.3nm in 2008.

***** FIGURE 2 ABOUT HERE *****

After XSEL secured access to international capital markets it has undertaken numerous acquisitions. The proceeds from the IPO were used, for example, to fully acquire at least seven privately held offshore holding companies that own (or control) other onshore Chinese media businesses (italics in Figure 2). It has established one new offshore company in the Cayman Islands (Xinhua Media Entertainment Ltd). Of these eight new businesses six were incorporated in the BVI, one in the Cayman Islands and one in Hong Kong. Seven of these companies in turn effectively control at least 29 mainland Chinese subsidiaries (compared to the sample average of 6.3) and a further eight offshore holding companies (sample average is 3.7). Through its 2007 acquisition of East Alliance Limited, a BVI holding company, XSEL now controls all of East Alliance's wholly owned subsidiaries and variable interest entities collectively known as M-Group, a mainland China based mobile service provider. These are controlled via contractual agreements which include a secured loan agreement, exclusive equity purchase option agreement, an equity pledge agreement and a subrogation agreement entered into with Wuxianshijie (Figure 2). Through these acquisitions XSEL has 17 offshore holding companies in total (sample average is 3.3). As a result of these acquisitions XSEL has been able to expand aggressively into a range of different areas of media, as well as greatly expanding its geographical coverage of the Chinese market.

The flexible and integrated use of a triad of holding companies in the Cayman Islands, BVI and Hong Kong, involving exploitation of their individual strengths as well as their complementarities, moreover, is very popular among Chinese MNEs (see Figures 1, 2, and 3). The use of these regions is facilitated by their very close financial and legal integration (Vlcek, 2013). All have been or still are overseas British territories. Their integration was also greatly promoted by Hong Kong's return to China in 1997. According to the IMF, the BVI sent a delegation to Hong Kong in 1989 to 'promote the use of IBCs to hold assets in

anticipation of the 1997 return of the colony to Chinese sovereignty' (IMF, 2004, 16). This promotional visit was followed 'by a significant increase in the registration of IBCs by Hong Kong residents, and it is estimated that a significant number of IBCs continue to be formed by residents of Hong Kong' (IMF, 2004, 16). Indeed, the bi-directional flows of capital registered between the BVI and Hong Kong are unusually large and it is 'common practice for Hong Kong companies to set up non-operating companies in offshore financial centres' (Census and Statistics Department, 2004, FC3). In 2007 the BVI was the largest recipient of OFDI flows from Hong Kong, receiving 47.8%. It was also the second largest inward investor to Hong Kong (after mainland China), responsible for 36.6% of all inward investment (Census and Statistics Department, 2007). These large flows between Hong Kong and the BVI, moreover, were due to 'the popularity for Hong Kong enterprises in setting up non-operating companies to channel funds back to Hong Kong or to other places' (Census and Statistics Department, 2007, 6). Hong Kong, moreover, has historically been by far the largest holder of OFDI stock in the BVI – making it the BVI's largest inward and outward investor (UNCTAD, 2004). It is thus perhaps unsurprising that the BVI appears to be the preferred location for business registrations and property rights transactions and also explains its popularity with Chinese investors.

4.3. Responsiveness to domestic institutional change: China's taxation policy

An important explanation for the use of THOFCs has been the preferential tax rates afforded to foreign invested enterprises (FIEs) in China which leads to 'round-tripping', a form of tax-induced regulatory arbitrage that involves moving capital offshore only to bring back onshore again in the guise of foreign direct investment, so as to benefit from preferential tax treatment (e.g. Huang, 2003; Fung et al., 2010; Vlcek, 2013). A variety of measures, however, have also been introduced to restrict the registration of offshore holding companies by Chinese

firms and discourage round-tripping. Since 2006, new regulations mandate that all Chinese nationals wishing to invest overseas must register with their local State Administration of Foreign Exchange (SAFE). More importantly, since January 2008 the new Enterprise Income Tax Law has harmonised tax rates for FIEs and Chinese businesses. This provides that enterprises established under the laws of foreign countries or regions but whose ‘de facto management body’ is located in the PRC be treated as a resident enterprise for PRC taxation purposes. This means offshore holding companies may now be subject to the PRC income tax at the rate of 25% for their global income. Such measures are, potentially, highly punitive to offshore holding companies. Indeed, under the law, dividends, interests, rent or royalties payable by a FIE to its foreign non-resident enterprise investors (and proceeds from the disposition of assets by a foreign enterprise investor) are also subject to an additional 10% withholding tax. As such the tax benefits of setting up offshore holding companies have been eliminated and replaced with disincentives. Looking at the most recent listings on US stock-markets, however, we find 40 of our sample firms filed their first 20-F form in 2008 or later (Table 2). 33 of these incorporated their listing vehicle in the Cayman Islands (and 7 in the BVI). The sample firms have increasingly incorporated a Hong Kong holding company to directly hold their mainland businesses. Between January 2005 and December 2009, 46 of our 72 sample firms had established a Hong Kong subsidiary, which, according to their annual reports, were established with a view to reducing their potential tax burdens. Every single one of the 330 20-F submissions made since the end of 2006 has specifically commented on the implications of new withholding taxes in China paid to offshore holding companies, including the preferential tax arrangements found in Hong Kong (that is a 5% instead of 10% rate). This demonstrates that offshore holding companies incorporated in THOFCs continued to be used even after the new enterprise income tax law, punitive to such offshore holding companies, took effect.

Actions Semiconductor provides us with a typical example (Figure 3). It is a leading semiconductor manufacturer specialising in the design and sale of portable media players. It was incorporated in the Cayman Islands in 2005 specifically to take advantage of, among other things, access to international capital markets: “[B]y incorporating our company in the Cayman Islands, we believe that we may have additional flexibility to pursue future business opportunities or financing alternatives” (Actions, 2010, 23). It completed its IPO on the NASDAQ in 2005, receiving net proceeds of US\$43.6mn. Since its IPO, it has entered into a series of strategic investments, including equity acquisitions in other international companies incorporated in the BVI. Actions Semiconductor has also been active in the reorganisation of its offshore organisational structure, establishing holding companies as “tax effective investment vehicles” to counter the new withholding taxes (Actions, 2010, 23). Shortly before the income tax law change was introduced Actions began to reconfigure the organisational structure of its offshore holding company and international and mainland China subsidiaries explicitly for tax purposes:

We determined that it is advantageous for us to adjust our investment structure to use Hong Kong companies to hold our interests in our PRC [People’s Republic of China] subsidiaries. On August 17, 2007 and September 6, 2007, we established two subsidiaries in Hong Kong which serve as the holding companies of our PRC subsidiaries. We wound up two BVI holding companies (Actions, 2010, 23).

Actions Semiconductor has changed its holding company structure so as to pre-empt the introduction of the new withholding taxes.

***** FIGURE 3 ABOUT HERE *****

A common theme found in sections 3 and 10 of the 20-F form (sections ‘Risks’ and ‘PRC taxation’, respectively) is the pending review of the tax status of our sample firms, particularly regarding the introduction of withholding taxes paid on dividends from mainland Chinese firms to offshore holding companies. Many of the sample firms clearly state that all necessary measures will be taken to mitigate the adverse impacts of any possible rescinding of preferential taxation rates currently applied, and cite the use of Hong Kong holding companies as a possible solution. In effect, disincentives to incorporate offshore (and round-trip) have been put in place. In this light, it is of interest that many of our sample firms still look to use offshore vehicles. In total 40 of our sample firms filed their first 20-F form in 2008 or later (Table 2), after the introduction of these withholding taxes. If these businesses were able to use alternative tax avoidance strategies to overcome the introduction of the new withholding taxes (such as transfer pricing strategies), it is not clear why they would go to the expense of incorporating these Hong Kong based holding companies. This suggests that lower tax rates alone are unlikely to be the sole explanation for the extensive use of the specific THOFCs we have identified.

The internalization theory of the MNE is based on the principle that firm boundaries are set at the margin where the benefits of further internalization just offset the costs (Buckley and Casson, 1976). Our findings suggest that while the costs of going offshore have increased, the benefits, in terms of mitigating the high costs of domestic market imperfections, still outweigh these additional costs. If round-tripping for lower taxes was the primary explanation for the use of THOFCs, we might expect to see a reduction in their use, but this is not the case (Table 1). To date most attention on Chinese MNE’s OFDI to THOFCs has been

placed on how such investments are driven by tax-induced regulatory arbitrage (e.g. Fung et al., 2010; Dharmapala and Hines, 2009). Following from this, the consequences this may have for biasing FDI as a measure of MNE affiliate activity have also been raised. This line of thinking, focussing on the value-added generated in havens, assumes that tax haven related FDI generates no other productive activity (Beugelsdijk et al., 2010). Chinese businesses, however, also appear to use offshore companies to mitigate the high transactions costs of specific domestic market imperfections and institutional constraints. A degree of caution, therefore, is required when thinking about what type of productive or unproductive activities may take place in tax havens. While it is true, in the sense of physical production of goods or services, that no productive activities may take place in THOFCs, this is not to say that such multinational activity does not serve other important functions.

Interestingly, macroeconomic modelling looking at the impact of tax havens also shows they create significant capital market competition (Rose and Spiegel, 2007). So while Beugelsdijk et al. (2010) are right to draw our attention to the large volumes of FDI channelled through THOFCs, care is required in thinking about the exact ways in which they are used. Our sample of firms, for example, shows that tax havens provide important financial services that are not supplied domestically. While many countries aspire to become tax havens, moreover, it is only those with the best governance and institutions that actually succeed (Dharmapala and Hines, 2009). Low taxes, therefore, are only one, albeit important attraction, of THOFCs. Comparatively superior capital markets and more efficient institutions for property rights are also driving Chinese OFDI to THOFCs, facilitated by multinational ABS providers (Wójcik, 2013).

5. Conclusion

The growth of outward FDI from emerging markets has become an important force shaping international economic geography. To date, however, the relatively high concentrations of national OFDI shares from the largest emerging markets to specific THOFCs have been somewhat overlooked. While financial geographers have consistently drawn attention to the importance of THOFCs (e.g., Roberts, 1995; Hudson, 2000), far fewer have looked at firm-level motivations for FDI to these jurisdictions, despite the very large volumes of global FDI flowing to them. This gap exists, in part, because the way in which firm-level financing decisions affects corporate economic geographies has been somewhat overlooked (Martin, 1999; Wrigley, 1999; Pollard, 2003). Motivated by the calls of financial geographers for greater research on how financing affects corporate, firm-level economic geographies, we used internalization theory as a complementary approach to further investigate the use of offshore incorporation in THOFCs (McCann, 2011). Based upon transaction costs and the theory of the firm, internalization theory provides an explicitly firm-level perspective relevant to MNEs. As such, it can provide insights into FDI location decisions in THOFCs. And although it is sometimes criticised as too closely following the precepts of neoclassical economics (Buckley and Casson, 1976), as it does not explicitly address the role of territory in the case of financial flows and systems, or the spatially embedded nature of MNEs (Martin 1999; Yeung, 2009; Seo, 2011), here we have taken these criticisms seriously. We have done so by casting ‘location advantages’ in terms of the institutional, legal institutional and social relationship setting of the source country (China), the proximate host countries (BVI and Cayman Islands) and the target countries, which include China (for “round-tripping”) or the US (for capital augmentation) as well as the eventual destination of the capital. In doing so, despite the relatively conventional theoretical stance employed, we have extended internalization theory and also contributed to areas of current interest in financial geography.

We argue that locality and its specificities do matter, are location bound, and also difficult to transfer. As such we take the MNE as an embedded network of relationships, focussing on financial relationships in particular. The spatial configurations of MNEs, moreover, are seen as the cause and agency of economic activity. The taxation and legal intuitions of all the relevant locations are perceived of as parts of integrated global value chains, centred on individual (Chinese in our case) MNEs but also embedded in all the countries in which they have activities. Using this approach our findings show Chinese MNEs invest in THOFCs vertically in order to access certain markets and institutions that are not available to them domestically. As well as this, they also address capital market imperfections in and through particular THOFCs, taking advantage of the respective specialisations of these spaces, as well as the networks that these jurisdictions are embedded within. Even despite increased regulation and higher costs associated with offshore incorporation, this has meant Chinese MNEs continue to undertake FDI to THOFCs to address the significant domestic market imperfections they face (cf. McCann, 2011). The case of Chinese MNEs investing in THOFCs therefore provides an interesting, albeit novel example, of how corporate financing and institutional misalignments drive FDI location decisions and corporate economic geography. The integration of spatial aspects into internationalisation theory allows us to extend the conventional scope of internalisation theory and to provide pointers to future theoretical and empirical advances.

In light of the global financial crisis, there have been increasing calls by financial geographers for the impact of ‘financialisation’ to be better incorporated and given more prominence within economic geography (Pike and Pollard, 2010; Pryke, 2011). Among financial geographers, moreover, it has also been noted that in spite of the great importance of THOFCs, including their links to world cities, advanced business services and general

financial system growth and development, there has been comparatively little research on them (Wójcik, 2013). Wójcik (2013, 338), for example, notes the irony of how in the lead up to the global financial crisis, ‘offshore finance seems to have been treated as a mere footnote to financial geography’. The same charge can be even more strongly levelled at IB scholars, who have, with one or two exceptions (Beugelsdijk et al. 2010; Sutherland and Ning, 2011), almost entirely elided this topic from the remit of their analysis, despite the huge volumes of FDI flows and stocks held offshore. Financial geographers have called for more research (Wainwright, 2011), including for the type of firm-level study undertaken here, which also incorporates consideration of emerging market MNEs (Wójcik, 2013). These are now strongly shaping international economic geography and, increasingly, the offshore world (Maurer and Martin, 2011; Vlcek, 2013; Wójcik, 2013). By cross-fertilizing ideas found in financial geography and mainstream IB and then applying them to how Chinese MNEs use THOFCs, we have made a start in addressing some of these prominent and important gaps highlighted by economic geographers (Wainwright, 2011; Wójcik, 2013).

In doing so we have provided some directions for a future research agenda for IB and economic geography scholars alike, pointing towards new directions in thinking about offshore incorporation and in turn the economic geography of the MNE. IB scholars can still do much more to learn from economic geographers and incorporate greater analysis of THOFCs in the study of the MNE. To repeat the words of Pollard (2003, 446), and an idea echoed by a number of other economic geographers (Dicken, 2011; Sarre, 2007), ‘finance is a fundamental part of economic co-ordination that is not logically prior to or separate from production’. IB scholars can learn from these calls and do more to consider the relevance of their theories of the MNE to the case of FDI activity to THOFCs. By the same token, economic geographers can learn from the firm-level approaches often employed in IB, thus

moving beyond study of ‘financial architectures’ and more towards how firm-level financing decisions influence corporate economic geographies (Wrigley, 1999). The approach we have employed here, moreover, with its detailed focus on firm-level data on offshore subsidiaries, provides a potentially useful method for further studies. In the first instance these could, for example, develop our opening paragraph further and look at other emerging market MNEs, such as those from Brazil, Russia and India, to see if our arguments regarding offshore incorporation are also useful in these cases.

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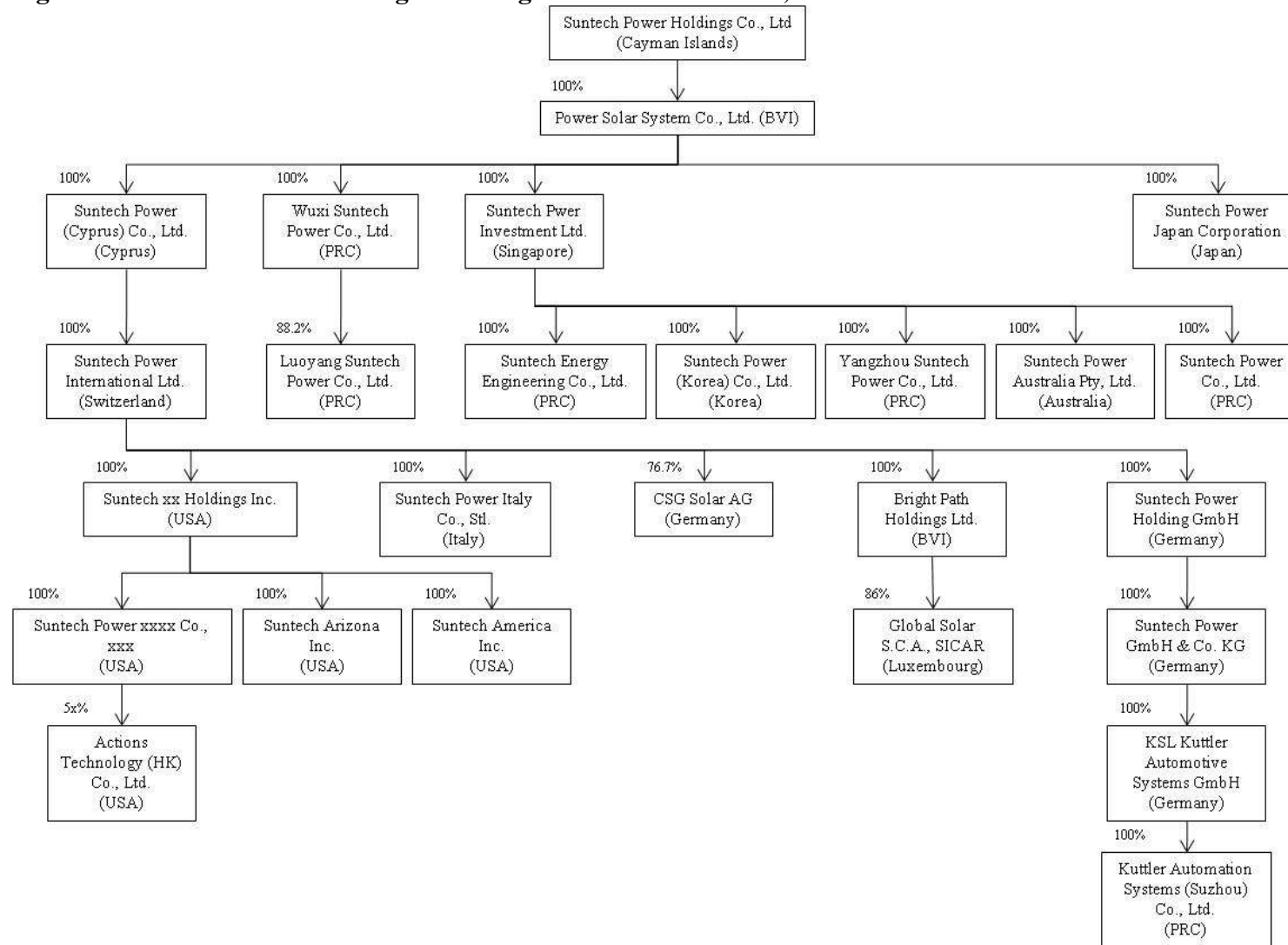
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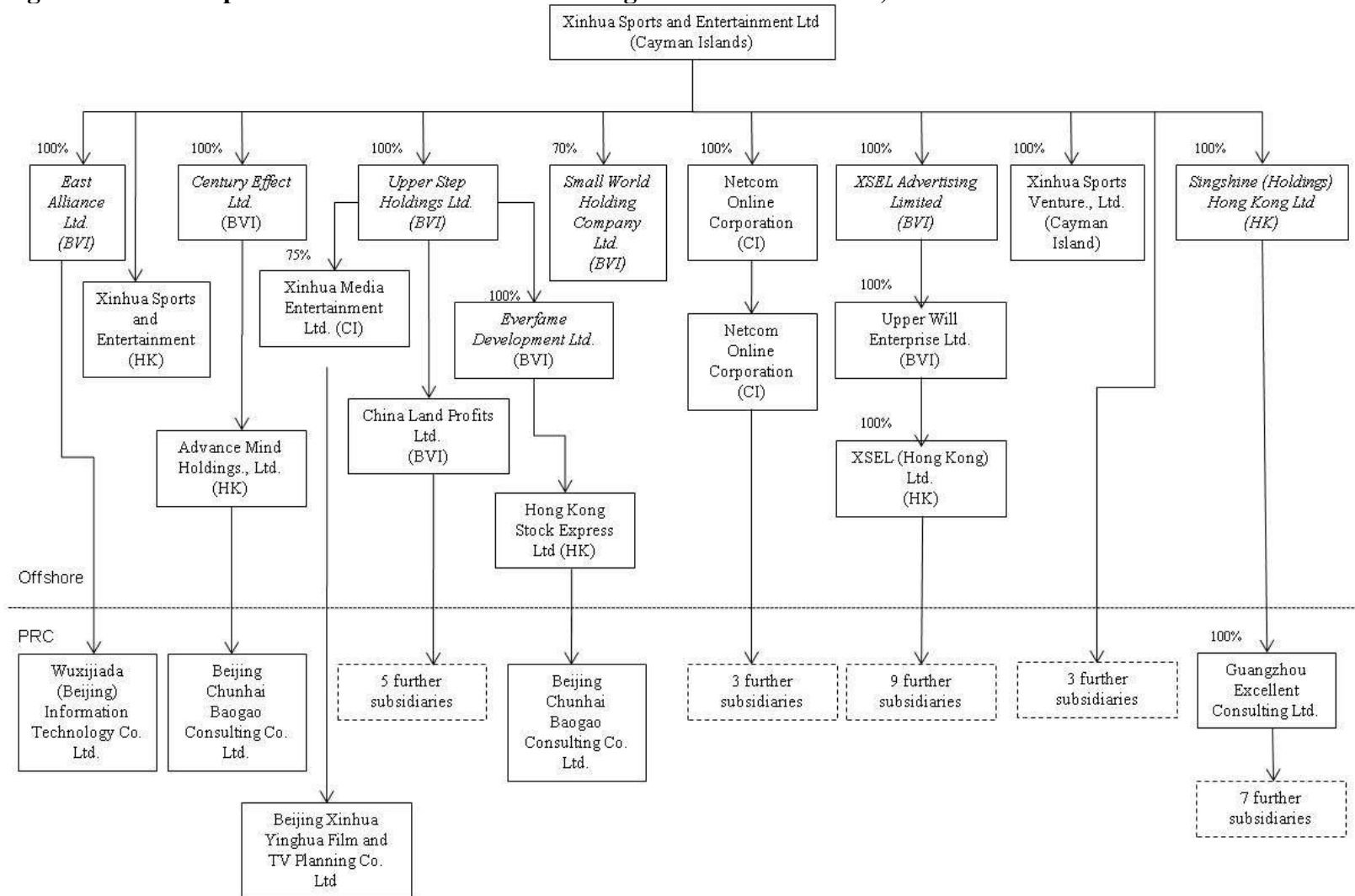
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Figure 1: Suntech Power Holding Co.'s Organisational Structure, 2010



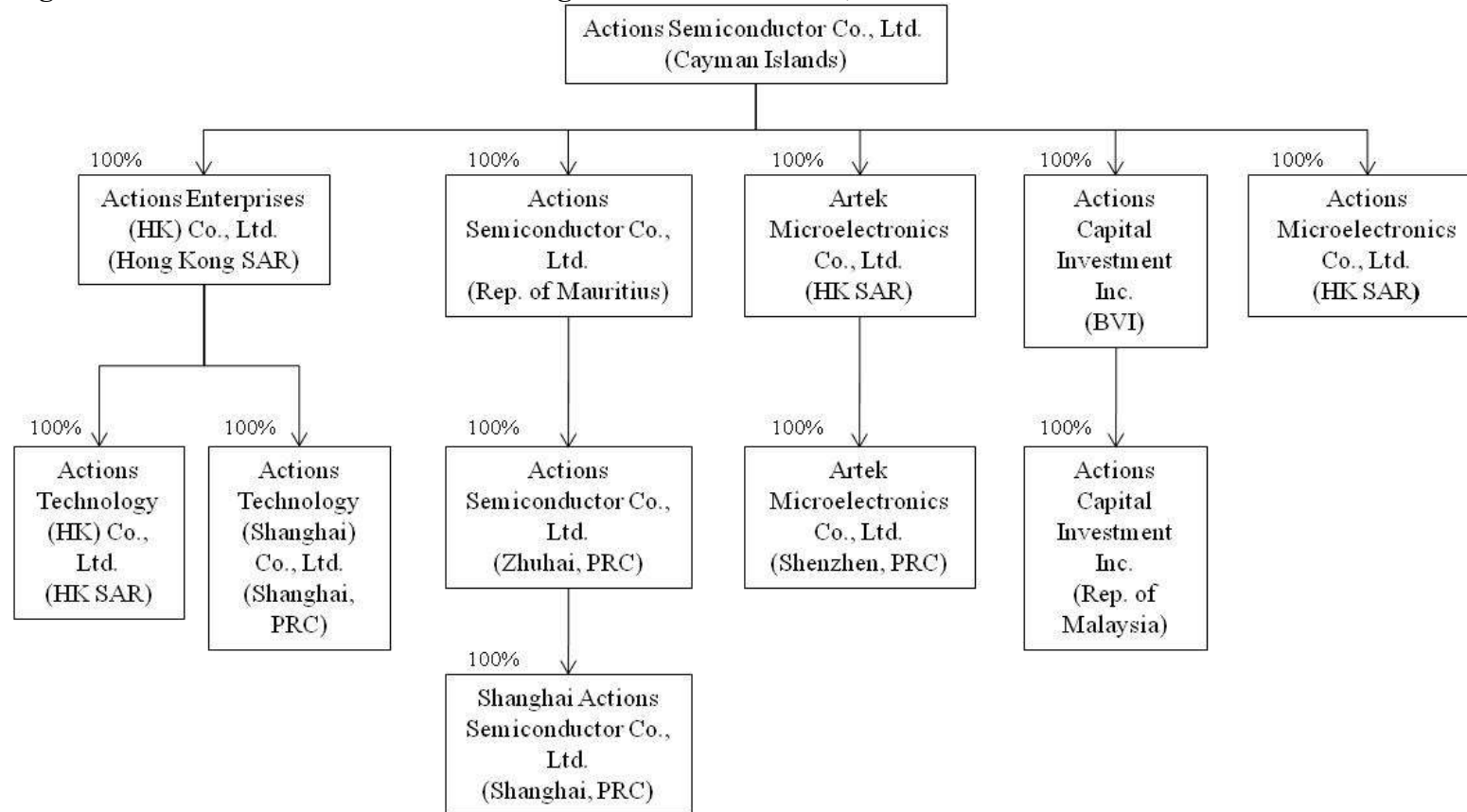
Source: Suntech (2010: 47)

Figure 2: Xinhua Sports and Entertainment Ltd.'s Organisational Structure, 2010



Source: Xinhua Sports and Entertainment (2010: 56)

Figure 3: Actions Semiconductor Co.'s Organisational Structure, 2010



Source: Actions Semiconductor (2010: 36)

Table 1: FDI flows between China and the Cayman Islands, British Virgin Islands, Hong Kong and other THOFs, 2003-2011 (US\$ bn and %)

	2003		2004		2005		2006		2007		2008		2009		2010		2011		Stock, 2011	
From China to:	bn	%	bn	%	bn	%	bn	%	bn	%	bn	%	bn	%	bn	%	bn	%	bn	%
Cayman Islands	0.8	28.3	1.3	23.4	5.2	42.1	7.8	44.4	2.6	9.8	1.5	2.7	5.4	9.5	3.5	5.1	4.9	6.6	21.7	5.1
BVI	0.2	7.3	0.4	7.0	1.2	10.0	0.5	3.1	1.9	7.1	2.1	3.8	1.6	2.9	6.1	8.9	6.2	8.3	29.3	6.9
Hong Kong	1.1	40.2	2.6	47.8	3.4	27.9	6.9	39.3	13.7	51.8	38.6	69.1	35.6	63.0	38.5	55.9	35.7	47.8	261.5	61.6
Other THOFs	0.0	0.0	0.1	0.0	0.1	0.0	0.2	0.0	1.1	0.0	1.6	2.8	4.0	7.0	5.0	7.3	6.6	8.9	22.6	5.3
Total THOFs	2.1	75.8	4.4	78.2	9.9	80.0	15.4	86.8	19.3	68.7	43.8	75.6	46.5	82.3	53.1	77.1	53.4	71.5	335.1	78.9
Total OFDI	2.9		5.5		12.3		17.6		26.5		55.9		56.5		68.9		74.7		424.8	
To China from:																				
Cayman Islands	0.9	1.6	2.0	3.4	1.9	3.2	2.1	3.3	2.6	3.4	3.1	3.4	2.5	2.9	2.5	2.4	2.2	1.9	n/a	n/a
BVI	5.8	10.8	6.7	11.1	9.0	15.0	11.2	17.8	16.6	22.1	16.0	17.3	11.3	12.5	10.5	9.9	9.7	8.4	n/a	n/a
Hong Kong	17.7	33.1	19.0	31.3	17.9	29.8	20.2	32.1	27.7	37.1	41.0	44.4	46.1	51	60.6	57.3	70.5	60.8	n/a	n/a
Other THOFs	5.4	9.8	6.1	8.9	6	10.5	7.1	11.2	9.2	12.4	12.3	13.4	9.1	10.1	7.9	7.5	10.7	9.2	n/a	n/a
Total THOFs	29.8	55.7	33.8	55.7	34.8	57.7	40.6	64.4	56.1	75.0	72.4	78.0	69.0	76.0	68.5	64.7	93.2	80.3	n/a	n/a
Total FDI	53.5		60.6		60.3		63.0		74.8		92.4		90.0		105.7		116.0		n/a	n/a

Source: MOFCOM, NBS, & SAFE (2008, 2012); National Bureau of Statistics (various years).

Note: 'Other tax haven and OFCs' comprises 44 countries based on Zorome (2007). The *China Statistical Yearbook 2012* does not publish inward FDI stock data.

Table 2: Our sample of 20-F forms

Year	Total number of sample firms	Number of sample firms submitting first 20-F forms	Total number of sample 20-F submissions
1999	1	1	1
2000	0	0	2
2001	0	0	3
2002	3	2	6
2003	3	0	9
2004	4	1	13
2005	11	7	24
2006	22	11	46
2007	32	10	78
2008	59	27	137
2009	66	7	203
2010	72	6	275

Source: Securities and Exchange Commission (2010).